No. 2777

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THE GOLDFIELD CONSOLIDATED MINES COMPANY, a corporation,
Plaintiff in Error,

vs.

JOSEPH J. SCOTT, as Collector of Internal Revenue, Fourth California District,
Defendant in Error.

POINTS AND AUTHORITIES FOR DEFENDANT IN ERROR

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FRANK D. MONCKTON, Clerk.

By....., Deputy Clerk.

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STATEMENT OF THE CASE

This is a Writ of Error from the Judgment of the District Court in an action against the Collector of Internal Revenue for the recovery of corporation excise taxes alleged to have been collected illegally and under protest for the years 1909 and 1910, under the Act approved August 5, 1909, in which the District Court sustained a general demurrer to each of the two counts of the complaint.

There are two counts in the complaint, one for each of the years mentioned, and the points involved

in each count are the same, with the exception that paragraph X of the second count, in addition to the statement of facts set forth in the first count, contains the further allegation that the tax for the year 1910 was assessed after the time for legally assessing said tax had expired.

ARGUMENT

I.

The Assessment for the Year 1910 Was Made in Time.

The fifth paragraph of Section 38 of the Act provides as follows:

> "The assessments shall be made and the several corporations, joint stock companies or associations, or insurance companies, shall be notified of the amount for which they are respectively liable, on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as above provided for, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint stock company or association, or insurance company immediately upon notification of the amount of such assessment."

In view of the foregoing, it is clear that the Collector could have made an assessment after June 1, 1911, and that his right thereto continued under certain conditions for a period of three years.

Paragraph VII of the second count of the complaint herein shows that the plaintiff made an amended return and that it was given until the 28th day of January, 1912, within which to do so. The complaint therefore shows upon its face that the first return made was not satisfactory and the Court will not be justified in determining from the complaint that the assessment complained of was made subsequent to the time when it could legally have been made.

See National Bank v. Allen, 223 Fed. 472, 478

In all other matters the points raised in the demurrer apply equally to each count and the argument of defendant in error will be addressed to the first count, it being understood that the points raised shall apply to each count.

II.

Neither Count of the Complaint States a Cause of Action.

In the first count the plaintiff asks for the recovery of $41,890.91 alleged to have been paid under protest, tax on a net income for the year 1909 of $4,189,091.61, the tax being calculated at the rate of one per cent thereupon. The plaintiff claims the right to a deduction against this income

as assessed for the item of depreciation for the year 1909 of the value in the ground before it was mined of 230,463 tons of ore of the value in place of $5,646,940.46. If such a deduction were allowed, it is apparent that there would be no annual income for the year 1909 subject to a tax.

The contention of the defendant is that the plaintiff is not entitled to the deduction claimed and that the complaint does not lay a foundation for any deduction from the amount assessed or for any refund from the amount taxed.

Section 38 of the Act of August 5, 1909, provides, among other things, that in determining the net income of a corporation of the class to which plaintiff belongs, there shall be deducted "all losses actually sustained within the year and not compensated by insurance, or otherwise, including a reasonable allowance for depreciation of property, if any." The law of the case is very clearly laid down in *Stratton's Independence, Limited,* vs. *F. W. Howbert,* Collector of Internal Revenue, 207 Fed. 419, decided in the District Court of Colorado on September 3, 1912.

In that case the plaintiff claimed a deduction equal to the value of the ore in place before it was mined of all the ore mined during the year for which the assessment was levied, and the Court said:

> "As to what is meant by the words 'net income' the relevancy of this results, of course, from the fact that the statute imposes an excise

tax of 1 per cent on such net income. Does 'net income' as thus used contemplate an allowance in favor of the company for ore in place extracted from the property or is it to be determined without such allowance? According to ordinary understanding it is undoubtedly true that in the operation of such corporations the ore extracted is not deemed an element to be reckoned with in determining the net income. In popular sense the net income of mining properties is the value of what is extracted after deducting the cost of extraction and treatment, and the cost of administering the company which may be conducting the operations, and finally after a reasonable reservation for contingencies. This is true not only as a matter of general understanding, but has been held uniformly by the courts to be a proper rule in determining whether or not a dividend is declarable by such companies. The doctrine as deduced from *People* vs. *Roberts* (156 N. Y. 585), Morawetz on Private Corporations. Sec. 442, and other authorities, is that the net income of a mining property for the purposes of dividends does not take into account so-called waste of the property by reason of the extraction of ore in place, but that such is to be determined by a comparison of the proceeds of the company, after a deduction for operation, expenses of the company, and such reasonable contingencies as may in the light of experience be expected. The following English cases, cited by the United States Attorney, are in point upon this: *The King* vs. *Atwood* (30 Revised Reports, 322); *Lee* vs. *Neuchatel Asphalte Co.* (41 Chancery Div., p. 1); *Coltness Iron Co.* vs. *Black,* assessor (6th Appealed Cases, p. 316); *Wilmer* vs. *McNamara & Co. (Ltd.)* (1805, Second Chancery, p. 245).

If, therefore, the net income is not affected for the purposes of dividends by the amount of

ore extracted, neither should it be affected by that circumstance for the purpose of an excise tax. We conclude, therefore, that the words 'net income' do not carry with them any contemplation of law that there shall be such a deduction as plaintiffs here claim."

And

"The ordinary definition of depreciation is the lessening of value. As applied to mining properties, the word carries with it, as in the case of any other business, the idea of deterioration in visible improvements, such as mills and other surface structures and perhaps the underground improvements, so far as they are put in by the hand of man, and, therefore, speaking popularly, when we think of depreciation in mining properties we think of a lessening in value by time, or perhaps by accident, of those physical elements which go to develop and to improve the property. How does this meaning, commonly entertained and accepted and which is common to every class of corporations, become enlarged in case of mining companies, so as to make the extraction of ore likewise an element of depreciation? The Court's view is that it does not. This conclusion is in part induced by the reasons which have been above discussed in connection with the term 'net income' and in part by the peculiar nature of the mining business. This latter is *sui generis*. It lives by dying. It is a business that is intrinsically uncertain. The segregation of part of a stock of goods is a definite detraction from the whole. The excavation of a body of ore, however, may reveal other bodies and result in immeasurable increment. The taking out of ore, while in a sense depreciation from the body, very often leads to the revealing of still larger bodies, and thus results not in a lessening of the value of the claims, but in a

great increase in such value. Mining excavation, when properly conducted, is very often more a development than a waste or a detraction. As applied to this class of corporation, having as its purpose to exhaust—it may be a year hence or a hundred years hence—the body of ore for profit, the mere fact that ore may be extracted does not, in my judgment, make the value of such ore an element to be classed and deducted as a depreciation of the property. The Court, therefore, holds as to this second provision of the statute that the extraction of ore does not constitute a credit in favor of mining companies upon the account between them and the Government when this excise tax is to be assessed."

That case subsequently went to the Supreme Court of the United States upon questions certified to the Supreme Court by the Circuit Court of Appeals for the Eighth Circuit and was reported 239 United States Reports, p. 399; 58 L. Ed. 285. The three questions certified were as follows:

"I. Does par. 38 of the Act of Congress entitled, 'An Act to Provide Revenue, Equalize Duties, and Encourage the Industries,' approved August 5, 1909 (36 Stat. at p. 11, Chap. 6, U. S. Comp. Stat. Supp. 1911, p. 741), apply to mining corporations?

II. Are the proceeds of ores mined by a corporation from its own premises income within the meaning of the aforementioned Act of Congress?

III. If the proceeds from ore sales are to be treated as income, is such a corporation entitled to deduct the value of such ore in place and before it is mined as depreciation within the meaning of par. 38 of said Act of Congress?"

The United States Supreme Court answered the first and second questions in the affirmative and the third question in the negative.

The Court, after carefully considering the issues raised by the questions submitted, said:

> "It is at the same time obvious that any method of stating the account that excludes all element of gain from the process of mining must, through one process or another, exempt mining companies from liability to tax under the Act of 1909 with respect to their mining operations. And so, an affirmative answer to the third question as propounded would be the same in effect as an affirmative answer to the first or the second. For it is a matter of little or no moment whether it is to be said (a) that mining corporations are not 'engaged in business' at all, or (b) that they are engaged in business, but the proceeds of ore mined are not income, or (c) that such proceeds are income, but that there must be allowed as depreciation all that part of the proceeds which remains after paying the bare outlays of the business. In either case mining corporations would be exempt from the tax.
>
> In our opinion, there are at least two insuperable obstacles in the way of returning an affirmative answer to the third question as certified.
>
> In the first place, it is fallacious to say that, whatever may have been the original cost of a mining property or the cost of developing it, if in fact it afterwards yields ores aggregating many times its original cost or market value, this result merely proves and at the same time measures the intrinsic value that existed from the beginning. We are here seeking the correct

> interpretation and construction of an act of legislation that was, at least, designed to furnish a practicable mode of raising revenue for the support of the government, and to do this in part by imposing annual taxes upon corporations organized for profit, and by measuring the amount of the contribution to be required from each corporation according to its annual income. The Act deals with corporations engaged in actual business transactions, and presumably conducted according to ordinary business principles. It was, of course, contemplated that the income might be derived from the employment of property in business, and that this property might become more or less exhausted in the process; and because of this, a reasonable allowance was to be made for depreciation of it, if any. But plainly, we think, the valuation of the property and the amount of the depreciation were to be determined not upon the basis of latent and occult intrinsic values, but upon considerations that affect market value and have their influence upon men of affairs charged with the management of the business and accounting of corporations that are organized for profit and are engaged in business for purposes of profit."

It is true that the Supreme Court made certain comments in its decision by which it limited the decision strictly to the issues raised by the questions as certified under paragraph 239 of the Judicial Code. We submit, however, that there is nothing in the case which conflicts with the contentions of the defendant here and that the net result of the law as laid down by the District Judge and the United States Supreme Court, constitutes a determination of the highest courts which have

passed upon this question in favor of the defendant here.

The only other case counsel has been able to find bearing upon this point is that of *United States* vs. *Nipissing Mines Company,* reported in 202 Fed. at page 803 and following. That case, however, did not have to do with the issues presented here. The whole question there was whether or not a deduction should be allowed for depreciation which was not entered in the books of the company as depreciation for the year and the further question as to the reasonableness of value fixed upon the ore in place. The point was not raised that the value of depletion in ore was not a proper item of deduction. This was perhaps due to the fact that the Treasury Department at the time that case was tried was allowing through an erroneous construction of the statute, deductions for depreciation upon that basis.

In view of the fact that in the Nipissing case the very contention which we deny here was admitted, it cannot be taken as the law of this case and should carry no weight in the decision of this case.

The cases of *Von Baumbach* vs. *Sargent Land Company,* 207 Fed. 423, and 219 Fed. 31, and *Mitchell Bros. Co.* vs. *Doyle,* 225 Fed. 437, cited by counsel for plaintiff in error, in his brief, are not in conflict with the foregoing contention of defendant in error.

Counsel for plaintiff in error made the point that the rules and regulations of the Treasury Department at the time this assessment was made, provided for a deduction such as is claimed here. Our answer to that point is that no rule of any department of the Government can alter or vary a statute, and the sole question before the Court here is the interpretation of the statute as enacted by Congress.

The judgment of the Court below should be sustained with regard to each count.

Respectfully submitted,

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